

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES AND)	
AUTHORITY TO BUILD AND FINANCE)	CASE NO. 8043
AN ELEVATED TANK OF HENRY COUNTY)	
WATER DISTRICT NO. 2)	

O R D E R

On November 24, 1980, Henry County Water District No. 2 ("Applicant") filed with the Public Service Commission, formerly the Utility Regulatory Commission, its application requesting (1) an adjustment of rates to its large retail and wholesale customers; (2) authority to construct a 300,000 gallon elevated storage tank; and (3) approval of the proposed plan for financing the proposed construction. Applicant stated that the proposed rate increase was necessary in order to recover the cost of pumping and delivering water to its large retail and wholesale customers. Applicant further stated the proposed construction project was necessary in order to improve the system's storage capacity and safeguard the proper operation of the system. The proposed rate adjustment would produce additional annual revenues of \$54,161, an increase of 16.4%, based on test year revenues from water sales.

On February 11, 1981, the Commission issued an Order directing Applicant to provide statutory notice of the pending rate increase and the scheduled hearing, set for March 18, 1981, to its consumers. On February 18, 1981, the Commission issued an additional Order wherein the hearing set for March 18, 1981, was rescheduled for May 27, 1981, and Applicant was directed to

provide statutory notice of the pending rate increase and the scheduled hearing to its consumers.

The hearing was conducted as scheduled at the Commission's offices in Frankfort, Kentucky, with all parties of record in attendance. Due to certain deficiencies in advertising the proposed rates, testimony concerning the proposed increase in rates was not heard. On May 27, 1981, the Commission issued an Order wherein Applicant was directed to provide statutory notice of the proposed rate increase and the June 30, 1981, hearing at which testimony concerning the proposed rate adjustment would be heard.

On June 15, 1981, the Commission issued an Interim Order wherein Applicant's proposed construction was approved and a certificate of public convenience and necessity was granted. This Order addresses Applicant's proposed financing and proposed rate adjustment.

On December 12, 1980, the Consumer Protection Division in the Office of the Attorney General filed a motion to intervene in this proceeding which was sustained. At the hearing of June 30, 1981, three of Applicant's wholesale customers, the cities of Eminence, New Castle and Campbellsburg, filed a motion to intervene which was sustained. The hearing of June 30, 1981, was conducted as scheduled with all parties of record in attendance.

COMMENTARY

Henry County Water District No. 2 is a water production and distribution system organized and existing under the provisions of Chapter 74 of the Kentucky Revised Statutes.

Applicant serves approximately 1,822 customers in Carroll, Henry, Oldham, and Trimble Counties in Kentucky.

TEST PERIOD

Applicant proposed and the Commission has accepted the 12-month period ending August 31, 1980, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to known and measurable changes where appropriate.

FINANCING

Applicant has proposed to borrow \$100,000 at an interest rate of 8%, through a one-year renewable note from the United Citizens Bank and Trust Company of Campbellsburg. The proceeds of this note will be used to finance the portion of Applicant's construction that will not be financed with Applicant's accumulated reserve funds. Applicant proposed to renew this note for a period of 24 months, thereby resulting in an annual payment of \$37,604, or \$112,812, over the term of the note. The Commission is of the opinion and finds that the proposed financing plan is for lawful objects within the corporate purposes of the Applicant, is necessary and appropriate for and consistent with the proper performance of Applicant's service to the public, and will not impair Applicant's ability to perform that service.

REVENUE REQUIREMENTS

Applicant did not make any adjustments to its test year statement of income, although it did refer to the increased debt

cost as a result of the aforementioned financing. The Commission has determined that the following adjustments should be made to reflect more current and anticipated operating conditions:

1. The Commission has reduced Applicant's test year revenues by \$15,900 to reflect the elimination of tap-on fees as an operating revenue item. These collections are customer contributions in aid of construction and should be recorded as such, and likewise, should be recorded as additions to Applicant's utility plant in service.

2. The Commission has increased Applicant's operating expenses by \$8,000 to reflect the increase in labor costs as the result of adding one new employee since the end of the test year.

3. The Commission has reduced Applicant's test year expense for electricity by \$9,728, from \$47,803 to \$38,075, for rate-making purposes. This adjustment reflects Applicant's pro forma expenses for electricity based on water losses of 15%. The Commission is of the opinion that Applicant's test year loss of 32% is excessive and that 15% is the maximum water loss that can be allowed for rate-making purposes.

4. Applicant's test year expense for chemicals has also been adjusted to reflect a reduction in water loss, to the 15% level.

5. The Commission has reduced Applicant's test year expenses by \$15,900 in relation to adjustment no. 1. These expenditures are capital in nature and should be recorded as such, rather than as revenues and expenses.

6. The Commission has adjusted Applicant's test year depreciation expense by \$3,917 to \$52,339. This adjustment utilizes Applicant's test year composite depreciation rate of 2.17% and contains two components. First, depreciation expense was increased by \$7,107 to include depreciation on Applicant's new \$327,500 storage tank and second, depreciation was decreased by \$11,024 to eliminate depreciation on contributed property of \$508,000.

7. The Commission has reduced interest income by \$8,262. This adjustment is based on the reduction in cash due to the cost of construction of the new tank, which will be paid for from Applicant's reserve funds. The Commission will include interest income of \$1,813 on the remaining funds of \$31,538.

The effect of all adjustments to Applicant's test year is as follows:

	<u>Actual Test Year</u>	<u>Adjustments</u>	<u>Adjusted Test Year</u>
Revenues From Sales	\$330,847	\$ -0-	\$330,847
Other Operating Revenues	40,017	(15,900)	24,117
Total Operating Revenues	<u>\$370,864</u>	<u>\$(15,900)</u>	<u>\$354,964</u>
Operating Expenses	257,166	(22,745)	234,421
Operating Income	<u>\$113,698</u>	<u>\$ 6,845</u>	<u>\$120,543</u>
Interest Income	10,075	(8,262)	1,813
Income Available for Debt Service	<u>\$123,773</u>	<u>\$ (1,417)</u>	<u>\$122,356</u>

In determining its revenue requirements, Applicant did not employ a rate of return or operating revenue approach.

The only basis indicated by Applicant for its requested increase was that it was not recovering its costs in selling water at 55 cents

per 1,000 gallons to the high volume consumers. The Commission is of the opinion that Applicant's revenue requirements should be based on a debt service coverage determined in the following manner: Income available for debt service should be sufficient to provide a 1.2 coverage on long-term debt service payments. The Commission is of the opinion that for rate-making purposes the short-term financing approved herein should be treated as long-term financing to be amortized over 20 years at an interest rate of 12%. The Commission is of the opinion that Applicant's customers should pay for the costs associated with the new storage tank over the expected life of the tank, which the Commission finds to be 20 years, rather than the actual 3-year amortization of the loan. The Commission further finds 12% to be a representative interest rate on waterworks revenue bonds recently sold in the private bond market and, therefore, has assigned this rate of interest to Applicant's \$100,000 indebtedness. This results in an annual debt service requirement of \$13,390 to be added to Applicant's annual payment of \$109,000 on FmHA long-term debt. A 1.2 coverage on combined debt service of \$122,390 requires income available for debt service of \$146,868, which is an overall increase of \$24,512 over adjusted test year levels.

RATES AND RATE DESIGN

Applicant proposed to eliminate its last rate block for sales over 100,000 gallons and adjust rates to its large retail and wholesale customers. The Commission concurs with Applicant's proposed reduction in the number of blocks within its rate schedule; however, the Commission does not accept Applicant's contention that the cost of delivering 1,000 gallons of water is 95 cents. The Commission also does not accept the methods utilized by

Applicant in arriving at this cost. Therefore, the Commission has reduced Applicant's proposed rates in accordance with the revenue requirements found reasonable herein.

SUMMARY

The Commission, after consideration of the evidence of record and being fully advised, is of the opinion and finds that the rates for water service set out in Appendix A, attached hereto and made a part hereof, will produce gross annual revenues from sales of \$355,359 and are the fair, just and reasonable rates for Applicant. The revenues from sales when added to other operating revenues will provide gross annual operating revenues of \$379,476.

The Commission further finds that the rates proposed by Applicant are unfair, unjust and unreasonable in that they produce revenues in excess of those found reasonable herein.

IT IS THEREFORE ORDERED that the rates set out in Appendix A, attached hereto and made a part hereof, are approved for service rendered by Henry County Water District No. 2 on and after the date of this Order.

IT IS FURTHER ORDERED that the rates proposed by Henry County Water District No. 2 would produce revenues in excess of those found reasonable herein, and, therefore, must be denied upon application of KRS 278.030.

IT IS FURTHER ORDERED that Henry County Water District No. 2 shall finance its current construction project by securing a renewable, one-year note for \$100,000 at an interest rate not to

exceed 8%. Further, this \$100,000 shall be used only for the lawful objects as set forth in the application.

IT IS FURTHER ORDERED that Henry County Water District No. 2 shall file with this Commission, within 30 days from the date of this Order, its revised tariff sheets setting forth the rates approved herein.

Done at Frankfort, Kentucky, this 24th day of September, 1981.

PUBLIC SERVICE COMMISSION

Marlin M. Vohs
Chairman

Katherine Bantale
Vice Chairman

Jim Carnegie
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE
COMMISSION OF KENTUCKY IN CASE NO. 8043
DATED SEPTEMBER 24, 1981

The following rates are hereby prescribed for all customers served by Henry County Water District #2. All other rates not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the date of this order.

Retail Customers

Consumption Block		Monthly Rate
First	2,500 gallons	\$7.50 (minimum)
Next	2,500 gallons	2.45 per 1,000 gallons
Next	5,000 gallons	1.65 per 1,000 gallons
Next	10,000 gallons	1.10 per 1,000 gallons
Over	20,000 gallons	.75 per 1,000 gallons

Wholesale Customers

All usage	.75 per 1,000 gallons
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